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Economic Conditions Governmental Finance United States Securities

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General Business Conditions

THE month of November has been another period of rising production and employment, with the gains again proving greater than most people expected. Even the optimists tended to underestimate the rate of improvement in the industries this Fall. Like everyone else, they were impressed by the indifferent prospects for the heavy equipment industries, the reduced farm income, the disturbed conditions abroad, and the substantial reasons for reluctance or inability to make new business expenditures. Hence the idea that the improvement would be at a modest rate. However, the difficulties in the way of getting ahead have carried less weight up to this time than the deferred need for goods, replenishment of depleted stocks, Government spending, and other causes of the upturn. The rise in productive activity has been as vigorous in its sixth month as when it started.

According to preliminary indications, the Federal Reserve index of industrial production for November will be 100 or higher, compared with 96 for October and 90 for September. This is a gain of better than 10 per cent in two months, on top of the earlier rise from 76 in May; and for the whole period the improvement has been about one-third, which is greater than any previously known in a like time. The rise in the Spring of 1933 was faster, but lasted only four months, and was followed by a severe slump. The present rise has been more orderly and has had more staying power.

December is usually expected to bring some decline in industrial activity, partly for seasonal reasons, and after a rise of the extent described a leveling off may be the next development. However, predictions that operations will be well maintained, allowing for the seasonal factor, are being generally accepted, due to the orders the industries have on hand.

The Present Outlook

Business sentiment has strengthened as the rise has proceeded, but no one would say that the doubts as to the extent and duration of the recovery have been wholly thrown off, or that the way is clear for a sharp revival of new enterprise. The chief need now, if business is to keep moving ahead, is improvement in the industries which thus far have been backward, and this is precisely where the outlook is uncertain and opinions divided. There is no limit to the business that can be carried on in this country, short of the limit imposed by productive capacity, if all the industries are going along together and supporting each other. But obviously depression in any one reduces the market for all. The automobile industry is making a strong showing this Fall, but not as strong as it would if the railways, the machinery and heavy equipment manufacturers, factory and commercial building, foreign trade, and the other relatively depressed occupations were giving more employment to people who undoubtedly would like to buy automobiles. The textile and apparel industries are doing better than at this time last year, but of course the unemployment in the areas mentioned limits the ability to buy clothing, except as derived from relief payments.

The essence of the situation is that automobiles, apparel, household equipment, and consumer goods industries and services generally are in a circle where each is providing better business for the others; residential building and public works have joined in the improvement; and all these together are giving support to the producers of steel and other metals. If the capital goods industries can be brought into the circle, the limit of the rise is far from reached. Conversely, it is recognized that a flattening out will be inevitable unless they are included.

Building Prospects Favorable

The best prospect for improvement in capital expenditures is in building, for there the trend is already established. Total contract awards during October were 77 per cent above last year, according to the Dodge reports, and in the first three weeks of November the increase was 35 per cent. With the activity in public works and publicly owned construction this Fall, it seems likely that the year's total, which

was behind 1937 until a few weeks ago, will end up at least 10 per cent larger.

To be sure, much of the building improvement is already effective in current industrial operations. It is responsible for the increase in cement production, and for lumber orders which in recent weeks have run 25 to 50 per cent better than last year. However, further gains in building in 1939 are in prospect. During the early months of the year there will be running concurrently the Federal public works program, the Federal public housing program, increased private residential building, and possibly also the beginning of improvement in utility and industrial construction. The Dodge Corporation estimates that residential, commercial and public utility construction will increase about one-third and that industrial building may nearly double this year's extremely low volume. Although public construction will decline in the second half year unless a new P.W.A. program is started, an aggregate building improvement of about 8 per cent is forecast, to the best figures since 1930 or 1931.

The prospect for railway equipment business is not promising. As to the outlook for machinery business generally opinions are divided. In past recoveries a rise such as that of the past six months in consumer goods would have led almost automatically to increased expenditures upon capital goods; but the lesson of events since 1929 is that the former sequence of steps in recovery can no longer be relied upon. Capital goods recovery followed consumer goods revival because the latter increased the need for productive facilities, and gave the manufacturing industries the means to finance expansion and improvement. Corporations earned more in times of active business, paid less of their profit to the tax collector, and if their own earnings were insufficient were able to increase their resources through sale of stock, since individual investors also paid smaller taxes and hence had greater incentive to take a risk. But equity financing now is rare, and bond issues are limited to the highest grades.

On the other hand, pessimism may be overdone. In mass production industries profits are poor in times of slow business, but tend to rise rapidly after volume climbs above the break-even point; machinery wears out and plants become obsolete as speedily as before; research and invention are as active as in the past; and competition requires the industries to put in cost-cutting improvements as rapidly as they can be financed and made to pay for themselves. The period just before the boom in the late '20s was derisively called "profitless prosperity," but the improvement of the industries went on endlessly.

Consumer Goods Position Stable

A second question as to the outlook concerns the stability of the situation in the industries where improvement has been most pronounced. The normal state of business is one of fluctuating volume and prices, and business men of experience may consider that a rise of one-third in production in six months is something to put them on their guard, for fear that consumption is again being exceeded. However, there are few signs of conditions such as normally precede a major business reaction. Merchants have bought carefully. They are expecting to do as good a holiday business as last year, in dollars, possibly better if the weather is favorable; but they are starting the holiday season with stocks 13 per cent below last year, according to department store figures for the end of October. Equal dollar sales will represent a larger movement of merchandise, because prices are lower.

Wholesalers have not overstocked, and manufacturers' preparations for the Fall and Winter season were conservative. The failure of bank loans to business to rise is a sign that the industries have not stocked up dangerously.

The steel and automobile industries have made the strongest contribution to the increase in industrial production during November. The steel mills received heavy orders for rolled products during the price cutting period in October, and afterwards from buyers who had missed the market. In November new business has been quieter but mills have been engaged on the October orders. As a rule forward buying results in some inventory accumulation and subsequent slackening, and operations have receded slightly from the mid-November peak of 63 per cent of capacity. However, the recession promises to be moderate. Structural steel orders will be helped by public works contracts and the price cut in tinplate, for which buyers had been waiting, should increase business.

Moreover, in the automobile industry optimism is unabated. Retail sales have been good, dealers' stocks still need building up, and assembly operations have been raised steadily, to an estimated 380,000 cars and trucks in November compared with 215,000 in October. This peak evidently will be held during December, except for the holidays. After the first of the year, as a rule, automobile operations slacken, with dealers stocked and sales seasonally sluggish.

The automobile industry is already giving as much support to business as can reasonably be expected in 1939, and this may be approximately true of the textiles also. Textile activity on the whole, measured with allowance for usual seasonal changes, is up over 40 per cent from the low. The strength in the woolen goods situation is conspicuous. Mills are booked well ahead on Spring lines, prices are firm, and buy-

ers are reported to be hurrying deliveries. There is good reason why the Spring woolen season should be satisfactory; it was extremely poor last year, which means that needs are greater, and there was no carryover of goods in the markets.

Commodity Markets Sluggish

The weakening of prices of industrial raw materials during the month might be construed as a sign of over-production, but the drop has not been sharp enough nor has it lasted long enough to require a pessimistic interpretation. Many buyers had lengthened their coverage during the rise in the markets which began last June, and having done so they have stepped aside, inasmuch as inducement to keep buying ahead is lacking. However, they are likely to be back with new requirements to be filled before the situation becomes depressing. The price rise from June to October was moderate, and so far as the markets have shown, forward buying and speculation have not been carried to dangerous extremes.

The policy of the producers of metals, rubber and other industrial materials in increasing their output, which has been partly responsible for the check to the price advance, is in the general interest. Undoubtedly prices could be forced higher and buyers kept in the markets by policies of restriction, but the result would be an unnatural scarcity and an almost compulsory speculation, which is the antithesis of prosperity. Rubber growers and foreign copper producers, both of whom operate under organized plans of control over shipments to market, have authorized increases in supplies. Rubber quotas in the first quarter will be 50 per cent of the enlarged 1939 base, against 45 per cent at present. The foreign copper cartel for the period Oct. 15-Jan. 1 is imposing no restrictions, and thereafter will allow 110 per cent of the base quota, which compares with 95 per cent prior to Oct. 15. Domestic copper producers individually have followed the policy of increasing production rather than attempt to force prices higher, and in the long run this policy will promote employment and stability.

The decline of the pound sterling of course has tended to weaken the dollar prices of commodities produced in the sterling area. It has been a factor in the drop in rubber, which at 8 pence in London is worth 16.20 cents here with sterling at $4.86, but only 15.40 cents with sterling at $4.62; also in the price of tin, of copper for export, and other commodities in which London is the principal market. The situation is a reminder that exchange depreciation in any important country affects the economic situation in all countries.

The Trade Agreements

The completion of the trade agreements between the United States and England and the United States and Canada is the culmination of long planning and careful negotiation by the representatives of the three powers, who in this country have been led by Secretary Hull. The purpose of the agreements is to place another and important check upon the tendency of the nations to try to make themselves constantly more self-sufficient; and this is an objective which everyone can wholeheartedly endorse. The tendency to increase barriers to world trade was strongly under way even before 1929. During the depression it was carried to such extremes of embargoes, quotas and prohibitive regulations that trade in many areas was throttled. Undoubtedly the policy has been a costly one for the whole world. The countries which practiced it have shut themselves off from the benefits of specialized production of goods in places best suited to produce them; they have substituted more costly production, and usually of inferior goods. Likewise, the producers who lost the market have suffered.

Secretary Hull has been the most persistent advocate of the counter-policy, namely, the liberalization of trade, and these agreements crown his efforts. Through our most-favored-nation policy the concessions made by this country will be extended to other countries than Great Britain and Canada, but of course the concessions apply chiefly to articles which we import mainly from those two.

The negotiation of the agreements has been by the usual process, namely, discussion around the table by representatives of the three principals, and undoubtedly it has been conducted in a spirit of mutual cooperation designed to balance the concessions justly and to achieve the greatest possible benefit with the least possible hardship. If the concessions were perfectly balanced, it would follow that the benefits and hardships would be equitably distributed among the three, with the benefits predominating in each case. Of course this perfection is unattainable, but objections to details should not lead to disapproval of the general program and its objective.

Any change in tariffs after the industries have accommodated themselves to the previous rates is disturbing, but it is almost impossible to foretell what the results of the revisions may be. Even those who are affected most by each change cannot foresee the total effect, which extends far beyond their own industry. If they can foretell fairly well how much they stand to lose in one way, they cannot tell how much they will share in the general benefits, and may overlook that side of it. It is difficult, in fact, to judge what the effects have been of the trade agreements previously executed, for it is impossible to isolate all the influences at work; the one certain fact is that the proportion of our trade with the agreement countries

has increased since the agreements were put into effect.

The chief objections to the terms of the new agreements have come from the New England textile industry, by reason of the reduction in the duty on fine woolens and cottons; from the producers of zinc, on which the duty was cut 0.35¢ under the Canadian agreement; and from the cattle industry, due to the provision which permits a greater entry of Canadian cattle at a lower duty. One of the outstanding benefits received should be the removal of the 10 per cent duty which Great Britain formerly imposed on lard. American hog growers will need the export market for lard in the next few years, as hog numbers are increasing.

Imports from Great Britain have been reduced in anticipation of the trade agreement, and should increase promptly after January 1, when it goes into effect. This will be helpful in improving the English trade balance and easing the pressure on sterling, which will indirectly benefit this country.

Money and Banking

Reflecting gold imports and Treasury disbursements for other purposes out of balances on hand in the Federal Reserve Banks, excess reserves of member banks rose further in November and on the 23rd reached $3,350,000,000, a new all-time high, exceeding the previous maximum reached December 11, 1935, by $50,000,000. The rise came rather unexpectedly, as it had been thought likely that the seasonal expansion of currency requirements would act as a brake until after the first of the year. However, the gold inflow, plus Treasury payments, proved to be the determining influences. Henceforward, until Christmas, currency requirements will increase more steeply, and, together with income tax collections and new borrowing by the Treasury on December 15, will probably reduce excess reserves between now and the end of the year. Thereafter, excess reserves should rise rapidly.

Since the previous high rcord of $3,300,000,000 in December, 1935, excess reserves have fluctuated over a wide range, falling as low as $700,000,000 in the Summer of 1937, after the doubling of reserve requirements of 1936 and early 1937. Thereafter, with the release of $300,000,000 of sterilized gold by the Treasury in September, 1937, and suspension of sterilization of new gold acquisitions, they recovered to $1,700,000,000 by April of this year when the President announced the new spending-lending program for promoting recovery. In consequence of the reduction of approximately 13½ per cent in reserve requirements at that time, desterilization of $1,400,000,000 of Treasury gold, and the heavy gold inflow of the past six months, they have been lifted once more to a new peak.

It should be borne in mind, of course, that excess reserves today are not entirely comparable with those in 1935. With reserve requirements still 75 per cent higher than at that time, the expansive power in deposits of a dollar of reserves is considerably less now than it was then. Were the reserve requirements of 1935 in effect today the present total of excess reserves would be nearer $5,500,000,000 than $3,500,000,000.

Final figures on gold imports for October revealed a total of $562,000,000, highest for any month on record. After subsiding for three weeks following the middle of October, the movement again expanded and for the first 18 days of November totaled $105,000,000. On November 23 the total gold stock of the country stood at $14,240,000,000, an all-time high.

Other Banking Changes

The rise in earning assets of reporting banks, in progress for several months, failed to carry into November, totals reacting approximately $200,000,000 from the October 26 peak. Declines were chiefly in holdings of "other securities," reflecting in large part retirement of New York City obligations and other maturities, proceeds of which remained uninvested. Banks showed a reluctance to make commitments in advance of expected Treasury financing on December 15, and their holdings of United States Government obligations likewise decreased. Commercial loans continued to recede slowly, and on the 23rd were close to the August low for the year.

Deposits declined in the first part of November, but rose again later. Balances due foreign banks increased to the highest in over a year.

In the short-term money market, discount rates under 0.03 per cent for Treasury bills continued to reflect the plethora of idle funds. In the bond market, Treasury issues reflected the usual hesitancy anticipatory to new Government financing, but in general the high grade market held steady. Second grade bonds, on the other hand, tended to react with the stock market. A feature of the municipal market was the establishment of new all-time records in low-cost financing by states, $19,000,000 Massachusetts 1-5 year bonds being sold at a net rate of about .675 per cent for an average life of three years, and $25,000,000 State of Connecticut 1-20 year bonds at an average cost of 1.51 per cent, the latter issue being especially attractive by reason of scarcity and special tax advantages. In the case of the Connecticut bonds, the yield on the 20-year maturity, as reoffered to the public, was 1.65 per cent.

Other public offerings during November included $25,000,000 4½ per cent bonds of the Republic of Argentina and $40,000,000 3 per cent bonds of the Dominion of Canada. Public

offerings of corporate securities were comparatively light, but private placements aggregating $140,000,000 were the largest for any month on record. Since the beginning of the year the total of such private placements has exceeded $500,000,000.

Foreign Conditions

Following a period of comparative stability around $4.75 during the forepart of November, sterling exchange again weakened, and in the latter part of the month sold down to $4.62⅝, or only 2⅝ cents above the low of the September war crisis. The British Equalization Account, which had already parted with huge amounts of gold during the previous two months in support of the pound, continued to cushion the fall, giving ground gradually under pressure, and ensuring an orderly market. Reflecting the weakness in sterling, bar gold in London rose to a new high price of 150 shillings per fine ounce. With the departure of foreign funds, interest rates have shown a slight hardening tendency which has been accentuated by seasonal influences.

As in the past, the pressure on the pound has reflected a combination of influences related only partly to the British position itself; uneasiness about European conditions in general has been a factor which recent developments in Germany and France have not helped to minimize. It is thought likely that the pound may be sharing a sympathetic weakness with the franc. Late in the month sterling rallied strongly to $4.68⅝, on short covering, buying for year-end requirements and more encouraging news from France.

Insofar as British trade is concerned, recent reports have appeared somewhat more favorable in that business indexes have been steadier. Industrial profits in the third quarter held up better than was expected, and the seasonal rise in unemployment this Fall has been smaller than last year. Moreover, recent foreign trade figures have indicated some narrowing of the adverse balance, the import excess for the three months ended October inclusive amounting to £94,900,000 against £118,900,000 in the corresponding period last year.

The following table shows the British balance of payments, visible and invisible items, for recent years; also the merchandise trade balance for the first ten months of this year and a year ago.

As the table shows, the merchandise balance for 1938 to date has shown improvement. On the other hand, the net returns from overseas investments, receipts from shipping, and on commission and other accounts probably have been lower than last year. It is important also from the standpoint of sterling that the United States excess of exports through October, amounting to $928,000,000, was the largest for any corresponding period since 1921.

British Balance of Payments*
(In millions of pounds)
Net Transactions on Current Account

Year	Excess of Imports	Invest. Income	Shipping, Commiss.	Other	Total Credits	Net Balance
1929......	—382	+250	+195	+40	+485	+103
1931......	—407	+170	+110	+22	+302	—105
1934......	—284	+170	+100	+ 7	+277	— 7
1935......	—275	+185	+100	+22	+307	+ 32
1936......	—346	+205	+115	+ 8	+328	— 18
1937......	—432	+220	+155	— 5	+370	— 52
10 months						
1937......	—341					
1938......	—329					

*Source: Board of Trade Journal.

Apart from British trade, sterling is of course affected by the trade balances of countries of the sterling area, and particularly those of primary producers, which have been less favorable during the past year. More recently, however, some improvement has occurred in the trade balances of Australia, British India and New Zealand, chiefly through declining imports, while in Argentina prospects of larger crops give promise of betterment ahead. With a continuance of business improvement in the United States, resulting in larger imports to this country and higher prices for primary products, the effects upon sterling countries, and world trade in general, would be beneficial.

The New French Recovery Program

The French program of financial and economic rehabilitation, promulgated by Premier Daladier and Finance Minister Reynaud, was inaugurated November 14 under extraordinary powers granted to the Cabinet by the French Parliament. Embracing some sixty decree laws thus far, the French three-year plan provides administrative economies and drastic increases in taxation designed to improve the 1939 budget by fr. 20,000,000,000. At the same time the gold stock of the Bank of France was revalued at the equivalent of 170 francs to the pound. With the gold "profit" of fr. 31,000,000,000, the Treasury was able to reduce its temporary overdraft with the Bank from fr. 48,134,000,000 to fr. 20,627,000,000, retaining a credit of about fr. 17,000,000,000. By the revaluation, the gold reserve was increased 56 per cent by value to fr. 87,264,000,000, though by weight remaining unchanged.

This gold "profit," together with tax receipts, is calculated to carry the Government through the next six months without public borrowing, thus, it is hoped, paving the way for private borrowing for plant modernization and new enterprise. It is expected, however, that some fr. 25,000,000,000, or about 10 per cent of the current national income, will have to be borrowed some time in 1939.

With a view to further encouraging production and repatriation of capital, the program provides for revised strike and arbitation procedure and removes practically all restrictions

on the hours of work, the forty-hour week becoming merely a basis for a reasonable overtime scale.

The program, when first announced, received a favorable reception in financial circles. Prices on the Bourse advanced and some fr. 1,500,000,000 are estimated to have been repatriated. Later the capital flow was again reversed, as the program encountered serious political opposition from the Left, which feels that unfair burdens have been placed upon the middle and lower classes, and from the Right, which objects that the decree-laws have not gone far enough. As we go to press, an attempted twenty-four hour general strike, called by trade union leaders as a demonstration against the Government's program, appears to have been unsuccessful.

Germany and Southeastern Europe

The extension of the German boundaries to include Austria and the Sudeten districts of Czechoslovakia, together with recent moves on the part of Germany towards closer economic relations with other countries in Central and Southeastern Europe, has occasioned renewed interest in the trade situation in those areas. The visit of the German Minister for Economics, Dr. Walther Funk, to Balkan capitals in October was indicative of German expansive policies, fruits of which have appeared in newly signed trade agreements with Poland, Roumania, Yugoslavia and Turkey. Under the Polish agreement, Germany has granted a credit of $24,000,000 for purchase of industrial equipment, while the Turkish agreement calls for credits of $60,000,000 for industrial and military purposes. News despatches tell of the placing of substantial orders by the Turkish Government for German railway material as part of a vast plan to develop the Turkish railways, of reports of negotiations for a loan to Greece, and of the raising of a large internal loan in Bulgaria for purchase of German military equipment (along with borrowing of a smaller sum in France for railroad supplies). Much significance attaches to the opening of the new Rhine-Danube canal, linking up water transportation from the North to the Black Seas; also to new projects calling for a great highway across Czechoslovakia and a canal system, likewise through Czechoslovakia, connecting the Elbe and Oder Rivers with the Danube.

The efforts on the part of Germany to strengthen economic ties to the East and South have been spurred no doubt by the recent statistics of German exports and imports, which reflect the adverse effects of the war crisis and of the general reduction of world trade of the past year. For the last several months, German exports, now including figures for Austria, have been running lower than a year ago, and the trade balance, with Austria included, showed an import surplus of Rm 283,000,000, as against an export surplus of Rm 310,000,000 for the same period of last year for the old Reich.

A motive more impelling, however, from a long-range standpoint arises from the character of the German economy and that of the territories recently acquired. Although striving under National Socialist rule to achieve the greatest possible self-sufficiency, Germany has been lacking in foodstuffs and primary materials such as iron ore, cotton, rubber and tin. Since 1933 she has been endeavoring to minimize this deficiency by developing her own natural resources and synthetic products, even at high cost. The acquisition of timber and iron and magnesite ore supplies in Austria—to mention leading products — and of important coal fields in the German parts of Czechoslovakia, should help to overcome some of these deficiencies, reducing import requirements in certain directions and facilitating the expansion of synthetic products, such as staple fibre.

At the same time, the fact remains that the new regions which Germany has obtained have considerably increased her industrial capacity. While some of the newly acquired industries may benefit by free access to the highly protected German market, others will face stiffer competition. Most of the industries of Austria, as well as those in the parts of Bohemia and Moravia that were taken over, have always obtained a large part of their raw materials and marketed most of their products—textiles, glass, porcelain and a great variety of fancy and luxury goods—outside the present German boundaries. In consequence, the German need for outside trade has been increased rather than diminished.

Character and Resources of Southeastern Europe

Divided into seven political units, Central and Southeastern Europe (excluding Germany, but including Asiatic Turkey) compares in size with our six Southwestern States of Missouri, Kansas, Arkansas, Oklahoma, Texas and New Mexico. Apart from Czechoslovakia, it is, like our Southwest, predominantly agricultural, though cotton plays a minor role, having been introduced comparatively recently in Turkey, Greece and Bulgaria. It possesses rich mineral resources, largely unexploited, including iron and chrome ore, copper, lead, bauxite and petroleum. In Greece shipping is an important industry.

Although, as the next table shows, industrialization has made considerable progress in the past decade, most of the population of 85,000,000 (more than four times that of our Southwestern States mentioned) still lives off the soil. As a result the available arable land is overcrowded, population density reaching in Bulgaria almost 300 persons per square mile.

Germany and Southeastern Europe

Country	Area (000 Sq. Mls.)	Pop. (000,000)	Agri. Pop. % of Total	Indust. Output 1937 % of 1929	Gold Reserve (Mill.$) June, 1938	1937 Trade (000,000 $) Exp.	Imp.
Germany	181.7	68.2	29	117	29†	2,372	2,193
Austria	32.4	6.9	32	106	46‡	228	273
Sudetenland	10.9	3.6	23	......	....	......	......
Gt. Germany	225.0	78.7	29	......	29	2,600	2,466
Bulgaria	39.8	6.3	82	132*	24	65	63
Czechoslovakia	38.1	10.7	38	96	92	417	383
Greece	50.3	6.9	53	151	25	87	138
Hungary	40.8	10.0	80	137	25	116	94
Roumania	113.9	19.6	81	132	124	226	131
Turkey	294.5	16.5	....	......	29	111	92
Yugoslavia	95.6	15.4	82	139**	55	145	119
S. E. Europe	673.0	85.4	....	......	375	1,167	1,020

†Reichsbank's reported gold holdings. ‡March 7, 1938. *1934 = 100. **Mining only; 1932 = 100.

Lacking capital, with primitive methods of cultivation and inadequate transportation facilities, Southeastern Europe has remained backward economically, despite latent possibilities for development.

Moreover, after the break-up of the Austro-Hungarian and former Turkish Empires, the customs barriers put up by the new national states disrupted old trade relations and prevented formation of new ones. Austrian and Bohemian industries found themselves barred from former markets, while Hungary and Roumania built factories with meagre capital to make products which could have been obtained only a few miles away at much lower prices.

In the desire to expand foreign trade, Germany has for various natural reasons turned to her neighbors in the Danubian Valley and the Balkans. Historically, the Reich has always had close relations with these areas. Before the war she was the leading customer of the Austro-Hungarian and Turkish Empires, and provided them in turn with a large part of their requirements. By 1929 she had recovered her place in the trade of these regions, and in the depression that followed common exchange difficulties and forced resort to clearing agreements to move goods tended to bring these countries still closer together, resulting in a tripling of their trade with Germany in the five years since 1933.

Moreover, in Vienna the Third Reich has inherited the traditional center of trade, transportation and finance of the country stretching to the East and South. Also, substantial Austrian and Sudeten capital investments have been brought under German control, thus tying the two areas still closer together.

Finally, there is the complementary nature of the products of the two regions.

Growth of Trade: The Exchange Clearing System

As her needs for primary materials have grown with her reconstruction and rearmament program, Germany has found it expedient to encourage the development of Southeastern Europe through investments, price guarantees, liberal credits and improvement in communications. As a result, new activities have been promoted which, while largely dependent upon German demand, have nevertheless diversified trade and added to the national wealth of the countries. In Bulgaria and Roumania, Germany has fostered the raising of soya beans, in Hungary of flaxseed, and in Turkey of vegetable oils and cotton, hoping in this way to reduce purchases in countries where payment in foreign exchange is required. In Hungary the mining of bauxite, the base of aluminum, has been stimulated in order to reduce dependence upon overseas copper.

Since 1933 Germany generally has bought more from Danube and Balkan countries than she has sold to them, thus reversing the previous trade balance. Soon these countries, themselves lacking capital and deficient in foreign exchange, found themselves accumulating blocked mark balances, and to secure the proceeds of their exports were forced to give preference to goods of German origin. In consequence, the share of Germany in the foreign trade of these countries has risen rapidly, as indicated by the following table. With the incorporation of Austria and Sudetenland into the Reich, the total share may be expected to increase.

German Share of the Trade of S. E. Europe

Percent of	Germany 1929	Germany 1933	Germany 1937	Greater G'y* 1937
Total Exports of:				
Bulgaria	29.9	36.0	43.1	47.1
Greece	23.2	17.9	30.5	32.2
Hungary	11.7	11.2	24.1	41.0
Roumania	27.6	10.6	20.1	26.9
Turkey	13.3	18.9	36.5	38.5
Yugoslavia	8.5	13.9	21.7	35.2
Total Imports of:				
Bulgaria	22.2	38.2	54.8	58.2
Greece	9.4	10.2	27.1	29.6
Hungary	20.0	19.6	26.2	44.2
Roumania	24.1	18.6	28.7	38.0
Turkey	15.3	25.5	42.1	43.7
Yugoslavia	15.6	13.2	32.4	42.7

*Germany and Austria.

Ultimate Effects Upon Trade

Final appraisement of the economic effects of what is taking place in Middle and Southeastern Europe must of course be deferred pending further knowledge of arrangements being entered upon and observation of preliminary repercussions and of progress in carrying out plans.

The absorption of Austria and Sudetenland by Germany means that the area in

which foreign trade is closely regulated and organized on a bilateral basis has been enlarged at the expense of the areas still adhering to multilateral trade principles. To what extent the expansion of German commercial interests in Southeastern Europe will result in a further narrowing of the areas open to world trade remains to be seen. The German Economics Minister, Dr. Funk, has stated that his government is motivated by a natural desire to establish close relations with the countries of Southeastern Europe, which have agricultural products and raw materials to export, and require manufactured articles, and has disclaimed any intention on the part of Germany to prevent other countries from trading in these areas or to promote political designs under the cloak of economic expansion. If the program can be carried out in this liberal spirit, the results may well be advantageous to all countries. As the London Times has pointed out, all countries could benefit from the development of a great area whose resources now lie undeveloped and unused. On the other hand, if the agreements have the effect of erecting barriers to outside trade, the consequences to trade at large will be adverse and the countries within the new economic area will be deprived of the full benefits of freer trade with each other.

That Danubian and Balkan countries are desirous of sharing their trade broadly with other countries has been made evident in numerous ways. Within the past month the ruler of Roumania has visited both London and Paris for the reported purpose of discussing trade and financial questions, and rulers of two other Balkan countries, Yugoslavia and Greece, have visited London, presumably on the same errand. What the outcome of these conversations have been has not been officially stated. Speaking in the House of Commons in November, Prime Minister Neville Chamberlain conceded that geographically Germany "must occupy the predominating position" in the Danubian area and stated that Britain had "no wish to block Germany out of these countries or encircle her economically." At the same time he pointed out that Great Britain has interests in these regions "and of course we mean to maintain those interests." Since last May Great Britain has granted armaments and trade credits of £16,000,000 to Turkey, while a more recent loan by France to Bulgaria was referred to at the outset of this article.

The Distribution of Income

One of the activities of the W.P.A. has been an inquiry into "Consumer Incomes in the United States," published recently under the sponsorship of the National Resources Committee, Washington, D. C. The Committee is composed of five cabinet officials, the Works Progress Administrator, and several well known private citizens. The report was announced as "A Federal Works Progress Project, conducted by the Bureau of Home Economics and the Bureau of Labor Statistics." The incomes studied were based on a sampling of approximately 300,000 families, living in cities and villages and on farms in thirty different states, and covered the period from July 1, 1935 to June 30, 1936. The sampling is not a large one, but the results appear to be reasonably consistent with those of earlier and more comprehensive studies.

In the first chapter of this report the stream of national income is described as flowing through all groups of the economic system in the form of money, but as finally converted into "real" income as follows:

> The money income thus received pours out again in exchange for food, for housing, for clothes and recreation, for all the goods and services that constitute the real income of the American people.

This distinction between "money income" and "real income" serves to emphasize the truth that real and final income distribution is not in money, but in the products and services of the industries.

Family incomes occupy most of the space, and the discussion begins as follows:

> The great majority of the Nation's consumers are members of families of two or more persons, sharing a common income and living under a common roof. The 29,400,300 families in the population during 1935-36 were by far the most important group of income-spending units, including 91 per cent of the total body of consumers.

An accompanying chart shows that—

> 14 per cent of all families received less than $500 during the year studied; 42 per cent received less than $1,000; 65 per cent less than $1,500, and 87 per cent less than $2,500. Also that above the $2,500 level about 10 per cent of all families had incomes up to $5,000, about 2 per cent had between $5,000 and $10,000, and less than 1 per cent had incomes of $10,000 or more.

One paragraph shows that the 42 per cent of the families which in 1935-36 received less than $1,000 each, together received less than 16 per cent of the aggregate income of all families, while 3 per cent with incomes of $5,000 and over received 21 per cent of the aggregate.

Another says that besides 115,906,000 persons in families, 10,058,000 persons were living as householders, lodgers or servants, and that the disparities among these were even greater. Thus 61 per cent received less than $1,000 and 95 per cent less than $2,500; also that a little over 1 per cent received $5,000 or more.

Another example divides the aggregate income into tenths, as follows:

> One-tenth of the aggregate income supports almost the whole lower third of the families and single individuals. The next tenth is divided among only half as many consumer units. The top tenth goes to one-half of 1 per cent of all consumer units—those with incomes of $14,000 and over.

The following paragraph combines three examples:

> Five per cent of the aggregate income supports 21 per cent of the consumer units at the bottom of the income scale, whereas at the top of the income scale

it supports only 0.1 per cent of the consumer units. Similarly, the lowest 1 per cent of the aggregate income is shared by 7 per cent of the consumer units, while the upper 1 per cent is shared by less than 0.0005 per cent of consumer units.

Studies of this sort are clearly valuable for their portrayal of the varied income conditions under which the American people live. The knowledge is perhaps especially desirable for those who live in the great cities and are familiar with city wages and the higher money values involved in city life. Incidentally much of the periodical and other literature the country reads is produced against the great city background.

Income inequalities, of course, are not a new discovery, or found only in the United States. They exist everywhere. Simply as inequalities they would not be remarkable, for people differ in many respects; but incomes that signify poverty and want are a social problem. While the standard of living is higher in the United States than in any other country, many family incomes are deplorably low.

What the Figures Mean

In interpreting the figures of this and other income studies the first important consideration is perhaps the very difference between different parts of the country in both the standard and costs of living. Income has a very different value and meaning in different sections, and the difference is especially marked between rural communities and cities. Income is to be interpreted in relation to outgo.

"America's Capacity to Consume," published in 1934 by the Brookings Institution, points out that government estimates of food and other materials produced and consumed on farms are computed at only 60 per cent of market prices. It is never possible to allow fully for the differences in the costs of living in varied conditions. On the farm rent is far less; clothing is simpler. Nature supplies freely many things the city pays for. Services are exchanged at less cost. Farming is a way of life not fully interpretable in monetary terms.

"America's Capacity to Consume" gives further information upon the low income groups which drag down the averages, and are largely responsible for the most striking comparisons. We quote from page 39:

> The twelve States which may be properly called the South comprise 18 per cent of the land area of the country, and have 21.5 per cent of the population, but have only 10.9 per cent of the total income. The low incomes of the South are attributable to a combination of factors including climatic conditions, the character and density of the population, and the economic maladjustments resulting from the Civil War. These twelve Southern states contain 50 per cent of the negro population of the country and 50 per cent of the tenant farmers!

In its chapter on "Incomes of Families" the Brookings book shows the importance of the farming population in the group of incomes under $1,000, and the influence of share-croppers in the farm group. Including all farm families, it says that in 1929 "the highest income of the 25 per cent of farm families at the bottom of the income scale was only about $500, while the corresponding income in the non-farm group was $1,305. Likewise the lowest 50 per cent of farm families included no income in excess of $910, while the lowest 50 per cent of the non-farm families included incomes as high as $1,890."

These figures are sometimes used to show that farmers do not receive a fair share of the national income, as reckoned on a per capita basis; but we have seen that a given income on a farm has a higher real value than a like income in a city; also, that the low farm averages reported do not represent the incomes of efficient farmers. The averages are lowered by the 48 per cent of the farmers who, according to the Department of Agriculture, produce but 12 per cent of the products that leave the farms. What the figures do prove is that low powers of production yield low incomes and low purchasing power.

It is interesting in passing to note that the industrial wage earners, whose rates of pay have been so largely increased in recent years, rank far above the lower third of family incomes. And of course these wage increases, to the extent they influence prices, have tended to increase the cost of living for farmers and unorganized workers who make up a substantial part of the lower third.

Another point that should be noted in interpreting this study, especially as to the higher incomes, is that the income figures shown are before the payment of income and other taxes. Under the Federal law incomes of less than $1,000 received by single persons are not taxable, and incomes of $2,500 received by married couples are exempt; and these two groups include 47 per cent of all returns for 1936. On the other hand, incomes in the top bracket are now taxed 79 per cent by the Federal Government alone, and the lower ones in proportion. The following table from "How the National Income is Divided," by Albert

Amount of Federal Income Tax (Including Surtax) Payable on Net Incomes of Various Sizes, 1929 and 1936*

Size of Net Income (In Dollars)	Amount of Tax Payable (In Dollars) 1929	1936	Percentage of Income Payable 1929	1936
5,000	7.88	48.00	0.16	0.96
10,000	83.25	343.00	0.83	3.43
20,000	633.75	1,469.00	3.17	7.35
50,000	4,779.75	8,621.00	9.56	17.2
100,000	15,959.75	31,997.00	16.0	32.0
500,000	115,959.75	304,616.00	23.2	60.9
1,000,000	240,959.75	676,428.00	24.1	67.6
5,000,000	1,240,959.75	3,787,334.00	24.8	75.7

*Computed from the income-tax regulations for a hypothetical person, married and with two children, earning his whole income (if less than $30,000), and having no tax-exempt interest income or salary.

G. Hart, Public Policy Pamphlet No. 23, University of Chicago Press, indicates the steep increase in the amount of income taken at various income levels by Federal taxes under both the 1929 and 1936 tax schedules.

Moreover, in addition to the Federal income taxes, numerous states levy graduated taxes on the same incomes, while, at death, estate and inheritance taxes exact a further toll of properties passing to beneficiaries. These "equalizing" influences should be taken into account, particularly when one tax is levied on corporation earnings and a second on dividends.

Gains Over the Years

Still another consideration in interpreting the figures is suggested by comparisons over the years, which show that at least until 1929 we had been making great strides in improving the condition of the lower income groups.

The best authority on the national income and its distribution, down to 1915 was "Wealth and Income of the People of the United States," by Professor Willford I. King, then in the Department of Economics, University of Wisconsin, and it is one of the most instructive books today. This book, p. 228, contains a table showing the distribution of family incomes by classes in 1910, and "America's Capacity to Consume," page 54, has a similar table for the year 1929 (19 years later). The 1910 table shows the number of families having incomes of less than $1,000 to have been 69.4 per cent of the total number of families and the table in "America's Capacity to Consume" shows the number of families in this class in 1929 to have been 21.4 per cent of the total number. The difference between these two percentages represents the proportion of families that had risen from below the $1,000 income to above it in the nineteen years.

Coming down to the latest study, it appears that in 1935-36, 42 per cent of all families received less than $1,000 per year. The figures for this and higher income groups compared with King's and Brookings' indicate that all groups had fallen from their 1929 positions, although still above their positions in 1910. The following table shows the position of each group in each of the three years named:

Income Group:	Percentage of All Families 1910	1929	1935-36
Less than $1,000	69.4	21.4	42
" " 1,500	90.3	42.4	65
" " 2,500	96.0	71.0	87

It will be seen that while the percentage of families receiving less than $1,000 diminished from 1910 to 1929, it increased from 1929 to 1935-36, and a like movement occurred in the other two groups. The three groups gained and lost together over the 25 years, 1910-1935.

Of course in this period there were changes in the cost of living; it went up considerably from 1910 to 1929 and down moderately from 1929 to 1935-36, but a precise allowance for these changes, with the sorts of families concerned, is not possible.

Gradations in Compensation

That there are gradations of income in every field of employment is a fact familiar to all. The ground floor is unskilled labor, but even here choice may be made and every degree of higher qualifications calls for appropriate pay. There are many rates of pay in railroading, from trackwalker to engineer, and so of the building trades. Under the N.R.A. codes organized labor insisted upon the pay differentials. The Communist theory of the same pay for all broke down when tried in Russia and was abandoned.

One of the most striking examples of pay based on results was seen in the case of Babe Ruth, who for several years drew down a larger salary than the President of the United States, because he brought dollars to the box office. The contrast between his income and that of his average admirer on the bleachers was as marked as in any of the examples quoted above. Moreover, the Babe's pay did not reduce the pay of other ball-players; on the contrary, it excited their emulation; more home-runs were made, interest in the game was stimulated, and the pay of all ball-players tended upward. The public paid for what it wanted. Similar examples are afforded among movie stars and other popular favorites, and this system of rewards extends throughout the professions and all business relations.

The desire to do one's best in every honorable effort has been fostered in youth of all lands, and has been the mainspring of progress. The ambition to excel has been lauded in the sports, and in business fields men have been honored for beginning at the bottom of the income scale and rising to the top. The discoveries, inventions and leadership of exceptional men have been a powerful factor in raising the general level of incomes.

These successful men have not come from any favored class, but have risen spontaneously from all groups and classes. The stories of the youth of Carnegie, Edison and Ford are so familiar that they need not be retold. They had worthy competitors who contributed to general results, but this only illustrates the natural gradations on the scale of success. In Carnegie's time the price of steel was more than halved, and the output in this country multiplied more than ten-fold. The cost of every machine was cheapened and the income of useful goods into every home was increased. Edison's creative work became the basis of one of the largest employing industries, and one of the most useful. Ford, beginning on a one man job, has created em-

ployment for more than 100,000 workers where no employment existed before, and has created the intangible income which comes from automobile ownership for more than a million families who use his cars. The income benefits distributed by these three men would be hard to calculate.

The Increase of Real Incomes

These examples, although conspicuous, only illustrate how the stream of "real income" in the form of commodities and services has been increased by improvements in the industries. The vexed controversy over income distribution would be greatly simplified by agreeing that this "real" income is the only kind that counts. If money-wages should be doubled, but production remain unchanged, the amount of "real" income would remain the same. On the other hand, incomes that spring from the industries, and are employed for their development, instead of lessening other incomes, actually increase them, and lift the entire population to new levels of comfort and well-being. Mr. Ford has just announced a $35,000,000 extension of his labor-employing "plant". The industry belongs to the Ford family, but income and products from it have been distributed to all parts of the world.

It is common knowledge that the industries are pouring income into the homes in ever-increasing volume and variety. Food, clothing and shelter are counted primary necessaries in the order named, and a recent Government report says that in 1840 77.5 per cent of the nation's workers lived on farms, but in 1930 this percentage had declined to 21.4. The disappearing 56.1 per cent had voluntarily shifted to other industries in which the pay was better. Within the last month announcements have been made of new mills in the South, to cost $20,000,000, for the production of clothing materials from new fibers. Last month, the Secretary of the National Retail Lumber Dealers Association stated that the average cost of new dwellings in 1938 is $850 less than in 1928, and that comparing the houses is like comparing automobiles of the same years.

The position of unskilled labor has been improved by invention and increasing use of capital equipment, which has lessened back-breaking drudgery and raised millions of workers to higher income levels than they had known before. Every new industry creates more trained workers and lowers the proportion of untrained in the total labor supply. The unskilled, low-paid, farm labor, which is not needed where it is, may find unlimited and well-paid employment as other industries develop and the supply of capital increases.*

Announcement of improvements in industrial technique have been coming so fast as to arouse fears that no work will be left to provide purchasing power. But this overlooks the fact that when the industries are in order and working together harmoniously their products pay for each other in the markets. The General Electric Company answered such fears in celebrating its recent sixtieth birthday. It stated that in this period the country's population has increased 2.6 times, factory jobs have increased three times, and factory wages in the aggregate have been multiplied eleven times over, notwithstanding all labor-saving inventions. The electrical industry was new in 1878, but in manufacturing and service now employs more than 1,000,000 persons.

More Production the Key to Higher Living Standards

Yet despite all that has been accomplished, the fact remains that poverty has not been abolished and the income of far too many of our people is low. What is the answer?

Even if equal division of the national income among all persons were practicable, which has never been so anywhere or at any time, it would not solve the problem of raising the average standard of living. The increased amount that each family in the lower income groups would get would be relatively small. More important, reduction of all incomes to the common average would diminish the personal incentive to get ahead. It would impair the fund of capital available for expansion of the industries, and this would be killing the goose that lays the golden egg. All the improvement which has been made in living standards has required the use of capital.

Everyone wants a higher standard of living, and no redistribution of income could raise the average. Only through increased production can the standard of living of the people as a whole be raised. This means: education, to develop greater competence and intelligence among workers; research, to develop new products and find better ways of doing things; and capital, to carry on the growth of the industries. Nothing can raise the low incomes to a decent subsistence level but the *use of more capital per capita,* as shown by the past growth of industry and agriculture.

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* Note—Public Affairs Pamphlet No. 12, written by Rupert B. Vance, of the Institute of Research in Social Science, University of North Carolina, says that "during the great migration of the twenties" (the post-war period of industrial expansion) "Greene county, Georgia, lost one-fourth of its white and two-fifths of its colored population."

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